Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Treatment of Operator Services Under Price Cap Regulation	)	CC Docket No. 93-124
	)	
Revisions to Price Cap Rules for AT&T	)	CC Docket No. 93-197

REPLY COMMENTS OF AMERITECH
REGARDING SECOND FURTHER NOTICE OF PROPOSED RULEMAKING

Ameritech[1] submits these reply comments regarding the Second Further Notice of Proposed Rulemaking in the Commission's local exchange carrier ("LEC") price cap performance review proceeding.[2]

I. CERTAIN CHANGES ARE APPROPRIATE FOR THE "BASELINE" PRICE CAP PLAN TO ENCOURAGE INNOVATION AND ECONOMIC PRICING.

A number of parties have opposed any significant changes to the "baseline" price cap plan except after the most rigorous proof of substantial competitive presence. These parties, however, have "missed the point" – especially with respect to several important changes that could further customer welfare by encouraging innovation and economic pricing with little risk of abuse by price cap LECs.

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[1] Ameritech means: Illinois Bell Telephone Company, Indiana Bell Telephone Company, Incorporated, Michigan Bell Telephone Company, The Ohio Bell Telephone Company, and Wisconsin Bell, Inc.

[2] In The Matter of Price Cap Performance Review for Local Exchange Carriers, Treatment of Operator Services Under Price Cap Regulation, Revisions to Price Cap Rules for AT&T, CC Docket Nos. 94-1, 93-124, 93-197, Second Further Notice of Rulemaking (94-1), Further Notice of Proposed Rulemaking (93-124), and Second Further Notice of Rulemaking (93-197), FCC 95-293 (released September 20, 1995) ("Second FNPRM").

A. New Services.

For example, several parties have opposed any significant relaxation of the current restrictions applicable to the introduction of new services. Time Warner claims that close scrutiny of new services is necessary or LECs will take the opportunity "to destroy nascent competition."[3] Ad Hoc suggests that all LEC new services be given the close scrutiny of Track 1 treatment to "protect customers of carriers from unjust carrier rates and practices" until "competitive conditions in the relevant market warrant relaxed regulatory treatment."[4] MCI supports continuing the Part 69 waiver requirement as well as the current tariff notice and cost support requirements for new services -- to "protect ratepayers."[5] MCI would permit the pricing of new services at any level above direct cost provided that the LEC make a downward basket PCI adjustment for any amount over direct cost,[6] which essentially ties pricing to direct cost by requiring the offering carrier to "refund" to its customers any amount over direct cost that it charges.

What these commenters have failed to acknowledge are three essential facts: 1) the current regulatory process contributes to delay and uncertainty and increases business risk, thus discouraging the introduction of new innovative services; 2) any restriction on a LEC's ability to price a new service according to its <u>value</u> in the market would create a significant disincentive to the LEC's investment in the development and introduction the new service in the first place; and 3) if the new service is not <u>mandated</u>

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[3] Time Warner at 10.

[4] Ad Hoc at 7-8

[5] MCI at 8-11, 15-18.

by the Commission, then the market will constrain a LEC's ability to extract more than a reasonable price for the service.

The current procedural requirements for the introduction of new services -- a Part 69 waiver (if a new switched access rate element is involved), a 45-day notice tariff filing with full cost support -- pose significant business risk. Delay and regulatory uncertainty is inherent in the process. In the case of new switched access rate elements, a waiver must be obtained prior to the tariff filing, and that process can take months or even years. The tariff filing itself provides an opportunity for entities to delay the provision of a competitive new service by the LEC and to obtain competitive information or to hinder the introduction of a new service that may be beneficial to the entities' competitors.[7] In addition, regulatory accounting cost-based pricing restrictions artificially limit a carrier's ability to set the price for a new service according to its value. Plus, the current tariff filing requirements also provide an opportunity for potential customers to use the regulatory process to try to obtain an even better price by challenging a LEC's cost or demand figures. These factors discourage the development and introduction of new services -- especially when investment decisions must be made substantially in advance of obtaining any regulatory approval.

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[6] Id. at 11.

[7] In the last two years, MCI has filed in opposition to all three of Ameritech's Part 69 waiver requests and to five of Ameritech's seven new service tariff filings. For example, MCI opposed Ameritech's directory assistance call completion Part 69 waiver request because Ameritech asked for a waiver of the wrong section of Part 69. The Commission, while agreeing that Ameritech asked for a waiver of the wrong section of Part 69, nonetheless granted Ameritech a waiver of the relevant section because it found that the proposal would "foster[*] competition and advance[*] a more economically efficient regulatory scheme." (DA 95-551, 10 FCC Rcd 4459 at ¶ 11.) There is some speculation that MCI opposed the waiver because it would have enabled other IXCs to offer a service in competition to the call completion capability it was planning to offer with 1-800-CALL/INFO.

Moreover, in the case of optional new services that are not required by the Commission, LECs have no undue leverage in connection with the pricing of those services. If a LEC is not required to offer a new service, it will presumably be introducing the service because it wants customers to purchase the service. And, if the LEC wishes to sell the service, it must do so at a price its customers perceive to be reasonable. If existing services remain intact, customers can be made no worse off with the introduction of the new service, regardless of the price at which it is offered. If the LEC's large and sophisticated access customers believe that the price of the optional new service is excessive -- that it is out of balance with the value of the service or the prices of alternatives -- they can simply choose not to purchase the new service and, if applicable, to continue using whatever existing services they do use or to purchase a substitute service from a competitor. If a significant number of customers believe that the price is excessive, the LEC will be compelled by marketplace forces to lower its price in order to sell the service. Given that the new service is optional, the LEC has no undo market power to force its customers to pay more for the new service than an amount those customers perceive to be the value of the service.

In this light, for those optional new services, tortuous regulatory procedures and regulatory accounting cost-based pricing restrictions that naturally operate to discourage innovation are completely unnecessary to ensure that rates are "reasonable." Thus, the requirement for any Part 69 waiver for these services should be eliminated (and no new separate "public interest" finding imposed) and tariffs should be permitted on 14-days' notice without cost support.

B. Lower Service Band Limits.

In the Second FNPRM, the Commission proposed the elimination of lower service band pricing limits. Specifically, the Commission noted:

> We believe this change will result in more efficient pricing, enhance competition, and will not adversely affect ratepayers.[8]

The Commission is correct. Current regulations that keep rates artificially high send uneconomic decision-making signals to both potential suppliers of communications services and users of those services, encouraging inefficient competitive entry.[9]

Nonetheless, LECs' competitors have opposed the Commission's proposal on the ground that it will create an opportunity for predatory pricing by LECs.[10] Such opposition ignores the fact that the Commission's proposal would really permit LECs to "rationalize" their rates. At the inception of price caps, LEC rates were burdened by the subsidies and inefficiencies involved with regulatory accounting cost-based rate setting. The Commission's proposal merely gives LECs additional flexibility to correct those inherent inefficiencies.

Moreover, claims of the dangers of predatory pricing are overblown.[11] And no evidence has been shown to indicate that this is a realistic risk. There is little doubt that LECs would never be able to successfully sustain any monopoly-level pricing in the future. This renders current below-cost pricing completely nonsensical. In addition,

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[8] Second FNPRM at ¶ 75.

[9] Id. at ¶ 25.

[10] See, e.g., Time Warner at 21-22.

[11] See GSA at 7.

the price cap basket and band caps themselves limit a LEC's ability to raise other rates to compensate for below-cost pricing of particular services.

Instead, these objections should be seen for what they are -- the self-serving requests of competitors to be insulated from price competition. In fact, their comments, many of which call for market share-based tests, seem to be intent on convincing the Commission to take all steps to ensure their success in the marketplace.[12] For example, Time Warner complains that increasing LEC pricing flexibility will "send a chilling signal to potential investors" and cause "potential facilities-based carriers [to] face dramatically increased business risks."[13] That these statements are truisms goes without saying. Obviously, if a LEC's rates in low cost areas are kept artificially high, potential entrants will be encouraged by the reduced business risk involved with the opportunity to price below the LEC and still reap supra-competitive profits. If, however, the LEC is given the flexibility to rationalize its rates, potential entrants will

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[12] Obviously, the Commission's concern should be with the competitive process itself, not with ensuring the success of any particular competitor or group of competitors. In that regard, the Commission should also view competitors' claims of "bad acts" with a healthy degree of skepticism. NCTA (at 13-14) cites to press reports of disputes between Ameritech and alternative local exchange carriers. For example, NCTA points to The Wall Street Journal's report of US Signal's complaints against Ameritech. What the report does not note is that many of US Signal's "non-negotiable demands" for forced balloting and reassignment of local customers, for termination of all of Ameritech's existing contracts with customers, and for free number portability to be subsidized by Ameritech were rejected by the Michigan Public Service Commission; that US Signal is succeeding as indicated by the fact that, as of late October, it served over 6,000 access lines (up from 100 lines in May); that the $240,000 refund it is seeking is for actual work performed by Ameritech for US Signal orders of physical collocation prior to the court ruling; and that the $1 million in legal fees likely includes a substantial amount incurred in the proceeding required to obtain and expand, US Signal's license, lobbying efforts in Michigan and Washington, and participation in the Michigan Public Service Commission proceeding to address interconnection issues on an industry-wide basis. Moreover, NCTA's reference to the reports of AT&T dissatisfaction ignores the fact that AT&T has demanded resale discounts of up to 35% for short term arrangements and that its methodology for arriving at those figures have been disputed by many parties -- including Sprint, Time Warner, Teleport, and MFS.

[13] Time Warner at 5.

face the increased business risk of true competition and will be encouraged to enter the market only if they can compete on truly economic terms.

Thus, the Commission should ignore these dire warnings that the sky will fall and, instead, eliminate the lower band limits and permit LECs the increased ability to rationalize their rates.

II. STREAMLINED REGULATION FOR LECS SHOULD NOT BE UNREASONABLY DELAYED.

In the Second FNPRM, the Commission noted:

> While the current price plan gives LECs greater incentives to operate efficiently and greater flexibility in setting rates, compared to rate of return regulation, it still imposes significant regulatory constraints upon carriers. Such constraints tend to become unnecessary or counterproductive as market forces become operational.[14]
>
> Rate regulation may distort the prices access customers pay for services by holding them at levels that are either above or below their economic cost. Prices set above the economic cost of providing service distort consumer decision-making . . . [and] also attract inefficient service providers . . .. Rates that are held below costs are equally undesirable because they also can distort decision-making by potential competitors concerning entry and investment in the market.[15]

Since streamlined regulation would provide LECs with the opportunity to adjust their rates in an economically correct manner which would send appropriate signals to potential market entrants, it is essential that the Commission not wait to grant this flexibility until competitive entry is substantially completed. Nonetheless, that is exactly what a number of commenters have suggested -- especially in advocating

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[14] Second FNPRM at ¶ 21.

[15] Id. at ¶¶ 24-26.

market share-based tests.[16] The attached report of Professor David J. Teece[17] demonstrates that such reliance on static market measures or overly rigorous checklists do not reflect an accurate view of the dynamics of the competitive process.

The Commission was correct in its initial conclusion in the Second FNPRM that:

> [T]he demand and supply elasticities are the most important factors to be considered in assessing the level of competition for LEC services for purposes of streamlined regulation . . ..[18]

Moreover, as Ameritech pointed out in its initial comments in response to the Second FNPRM, given the nature of the access service market and its customers, the only real issue is supply responsiveness.[19] In that light, Ameritech proposed a reasonable two-pronged safe harbor trigger for streamlined regulation: (1) the availability of competitive facilities to customers representing at least 25% of all access traffic in the relevant market, which facilities can accommodate immediately at least 1/5 of the traffic represented by those customers; or (2) the elimination of entry barriers to local exchange competition (tariffs for unbundled loops and ports, arrangements for interconnection of competitive local exchange networks including reciprocal compensation, local number portability, and access to numbering resources) and the presence of at least one certified competitive local exchange carrier offering service in the geographic area in question.

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[16] See, e.g., Time Warner at 55, AT&T at 17.

[17] Attachment A.

[18] Second FNPRM at ¶ 146.

[19] See Ameritech Comments at 24-39.

As the analysis of Professor Teece concludes, the Ameritech proposal is a reasonable safe harbor that will not unnecessarily delay LEC pricing flexibility beyond the point at which competitive pressures are sufficient to justify streamlined regulation -- as long as the Commission permits LECs to petition for streamlined relief in appropriate cases even when those criteria are not met. As Professor Teece points out, no one checklist can adequately capture all factors that might appropriately reflect competitive pressure on LEC-provided access services. Unreasonably delaying streamlining for LEC services only delays the benefits that streamlining will bring -- increasing incentives for greater efficiency, innovation, new services, and full price competition.

Respectfully submitted,

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Report on the Assessment of Local Telecommunications Competition

January 1996

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I. Introduction

A. Qualifications

My name is David J. Teece. I am Mitsubishi Bank Professor, Haas School of Business, and Director, Institute for Management, Innovation and Organization, University of California at Berkeley. I have been a full professor at Berkeley since 1982. Prior to that, I was Assistant and then Associate Professor of Business Economics at the Graduate School of Business, Stanford University. I received my Ph.D. in Economics from the University of Pennsylvania in 1975. As an industrial organization economist, I have studied the economics of technological change, competition policy, and business strategy issues for over two decades. At U.C. Berkeley, I was the Co-founder of the Management of Technology Program, a joint program between the School of Business and College of Engineering, and the Consortium on Competitiveness and Cooperation, a multi-campus research program linking scholars at Berkeley, Stanford, Columbia, Harvard and Wharton who have deep and enduring interests in the long-run performance of the U.S. in the global economy. I am also faculty director of the Telecommunications Policy Program at U.C. Berkeley.

My research has been centrally concerned with the relationship between the structure of firms (especially the scope of their activities) and their performance, particularly the capacity to develop and introduce new technologies. I have had a special interest in innovation, organizational structure and antitrust. Relevant books include Antitrust, Innovation, and Competitiveness (1992, with T. Jorde) and The Competitive Challenge (1987). Relevant papers include "Telecommunications in Transition: Unbundling, Reintegration, and Competition," (Michigan Telecommunications and Technology Law Review, 4 (1995)) and "Competition and Unbundling in Local Telecommunications: Implications for Antitrust Policy," (with Robert G. Harris and Gregory L. Rosston, published in Towards a Competitive Telecommunications Industry: Selected Papers from the 1994 Telecommunications Research

Conference, Gerald Brock (ed.), (Lawrence Erlbaum Associates, 1995)). I have recently submitted two papers to the Federal Communications Commission and two affidavits to the Department of Justice in 1994 in support of Ameritech's Customers First Plan (CFP). In preparing these papers, I devoted considerable attention to studying the competitive dynamics of the telecommunications industry and to developing and implementing a methodology with which to assess the competitive environment. I also submitted testimony on behalf of AT&T in U.S. v. AT&T.[1] My credentials are more fully outlined on my curriculum vita, attached hereto as Exhibit One.

B. Purpose of Report

Ameritech has requested that I review the FCC's Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197 (hereinafter "second FNPRM") and evaluate the Commission's suggested measures of local competition to be employed in deciding whether a LEC will receive greater flexibility under price cap regulation. Additionally, I have critically examined the comments of various industry participants and their arguments advancing methods for measuring local competition and granting the LECs' streamlining requests.

This report will explain why the proposals of various commenters,[2] if implemented, would be counterproductive. I will also offer an analytical framework that utilizes a prospective evaluation of demand and supply conditions as they exist in the particular relevant market under study. In so doing, my proposed methodology considers factors that inform the decisionmaker as to the likely state of local competition looking forward. Put differently, rather than delaying much

[1] United States v. Western Electric, Inc. and American Telephone and Telegraph, action 82-0192.

[2] All references herein to "commenters" refers to those parties whose comments were provided to me by Ameritech. I requested and received a reasonable cross-section of comments representing both customers and competitors of LECs, including AT&T, MCI, Time Warner, CompTel and NCTA.

needed streamlining, and hamstringing the LEC's ability to compete, my proposals facilitate decisionmaking that supports the continued development and acceleration of local telecommunications competition.

My report is organized as follows. In Section II, I survey the several of the comments filed with the Commission and explain why they are flawed, both in terms of economics and sound public policy. If adopted, certain recommendations would grossly distort the analysis of the competitive landscape and generate regulatory policy devoid of sound economic reasoning. New entrants would be the recipients of artificial and unneeded competitive advantages vis à vis the incumbent, to the ultimate detriment of the telecommunications consumer. Section III advances several factors which should be incorporated into the Commission's analysis of local competition for purposes of granting regulatory relief. In particular, I explain why defining the relevant market is a necessary first step, and how demand and supply responsiveness provides valuable insight into assessing the state of current and future competition. Section IV offers some concluding remarks.

II. The analyses put forward by various commenters are flawed and, if implemented, would lead to regulatory policymaking that slows innovation and denies consumers the benefits of enhanced competition.

While many commenters appear interested in fostering local telecommunications competition and the development of new services and delivery mechanisms,[3] some recommendations are thinly veiled efforts to maintain LEC regulatory oversight as LEC businesses grow increasingly exposed to competitive incursions, both intra- and inter-modal. Proponents of market share tests and asymmetrical reporting requirements are merely advancing

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[3] *See, e.g.*, MCI Comments at page 23: "Technological change is eroding the scope of any natural monopoly for telecommunications, and has created the need for a regulatory paradigm allowing competition to serve the public interest."

backward looking methodologies designed to distract attention from powerful emerging and emergent actual and potential competition. Furthermore, the competitive checklists advanced by commenters are flawed, as they ignore potential competition altogether and fail to capture important sources of actual competition such as private networks and other forms of bypass. In essence, many commenters focus singlemindedly on historical competitive structures without recognizing that it is the incumbent's vulnerability to competitive pressures, potential as well as actual, that effectively restrains anticompetitive behavior.

Many commenters fail to recognize that maintaining regulatory oversight once it is no longer necessary imposes enormous costs in the form of foregone consumer benefits. These benefits manifest themselves in the form of greater efficiency, new services, and declining prices. When regulatory constraints supplant the workings of an otherwise competitive marketplace, incentives to invest the required resources to bring about these benefits are dampened. This is especially so in industries such as telecommunications that are characterized by rapid technological advance. In such contexts, regulators can never respond fast enough to new competitive realities.

The Commission recently took note of these concerns, acknowledging that dominant carrier regulation impeded AT&T's ability and incentives to develop and offer new services in the long-distance marketplace. The Commission stated:

> "The cost of dominant carrier regulation in this context includes inhibiting AT&T from quickly introducing new services and from quickly responding to new offerings by its rivals. This occurs because of the longer tariff notice requirements imposed on AT&T, which allow AT&T's competitors to respond to AT&T tariff filings covering new services and promotions even before AT&T's become effective. The longer notice requirements imposed on AT&T thus also reduce the incentive for AT&T to initiate price reductions. In addition, to the extent AT&T were to initiate such

> strategies, AT&T's competitors could use the regulatory process to delay, and consequently, ultimately thwart AT&T's strategies."[4]

The same needless costs threaten local exchange and access services if regulators fail to adopt a forward looking approach to competitive assessment and instead embrace the proposals advanced by certain commenters in this proceeding.

In the remainder of this section, I will review and critique some of the commenters' principal recommendations and explain why they would not serve the Commission's stated goals of (1) encouraging market-based prices, (2) encouraging efficient investment and innovation, (3) encouraging competitive entry into local telephony and (4) permitting the Commission to regulate noncompetitive markets in the most efficient and the least intrusive way.[5]

A. Commenters are asking the Commission to pre-judge the state of local competition.

Although the commenters differ in their recommendations for measuring local competition, they all appear convinced that local competition does not exist today, and will not exist for the foreseeable future.[6] Indeed, their proposed methodologies all but guarantee such a finding, as they implicitly dismiss emerging technologies and services by limiting their review to current competitors, technologies and services. Yet it is emerging technologies and new competitors using different strategies which provide the most powerful forces of competitive change.

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[4] Federal Communications Commission Order in the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, October 23, 1995 at ¶27. (hereinafter "AT&T Non-dominant Order")

[5] Second FNPRM at ¶1.

[6] *See, e.g.*, AT&T Comments at page 2: "... the comments in Phase I of this proceeding left no serious doubt that the LECs' monopoly power over [local exchange and access services] will continue well into the future."

The orientation of most commenters to competition assessment stands in stark contrast to the position enunciated by the FCC:

> "lowering entry barriers is the most appropriate mechanism for conditioning additional price cap flexibilities because additional flexibilities within the price cap framework are forms of regulatory relief that are intended to allow the LECs to respond to *emerging* competition, and in some cases allow efficient competition to occur."[7] [emphasis added]

In the face of the FCC's enlightened position to not impose any restrictions that are not absolutely necessary, as well as the mainstream literature on competition in industries characterized by rapid technological change, the singular focus on actual competition and static market statistics is both anachronistic and misdirected. The FCC properly recognizes that regulatory streamlining should be designed to position the LECs for the competitive environment of the future and should not be conditioned on mechanical formulae or checklists that rely solely on a snapshot of yesterday's marketplace and fail to address the conditions that impact the form, pace and degree of future entry. Indeed, the FCC has previously recognized that local telecommunications markets are shedding the attributes that provided the historical justifications for many regulations:

> "Significant developments in access service and long distance service competition, the introduction of new technologies and services, and the significant changes in the regulatory treatment for many of the larger LECs have eroded the fundamental basis for many of the access charge rules."[8]

B. Ameritech's proposed competitive checklist provides the Commission with a safe harbor for reviewing streamlining requests.

Several commenters turn to a competitive checklist as the most reliable means for measuring the existence and intensity of local competition. Representative of the commenters'

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[7] Second FNPRM at ¶106.

[8] Access Reform Task Force, FCC Staff Analysis, "Federal Perspective on Access Charge Reform," April 30, 1993 at p. 3.

position is MCI, who states that "A competitive checklist is necessary to assure that entrants can effectively compete with the incumbent LEC."[9] A competitive checklist is not without value, but an evaluation of competition that rests solely on the categories recorded on the commenters' checklists will very likely lead to regulatory policymaking that does not take into account the particular competitive landscape facing the incumbent and its rivals. As a result, regulatory streamlining will be postponed even as the incursions of new entrants render the extant framework obsolete.

The checklists of various commenters are uniformly characterized by analytical overkill, as any reasonable standard for relaxation would be met long before a LEC could traverse the gauntlets concocted by AT&T and MCI. AT&T develops a nine step list that the company deems necessary, but not necessarily sufficient, for competition to develop in local telephony services.[10] AT&T explains that

> "After the competition-enabling conditions have been established and have had a reasonable time to operate, the Commission could assess the competitiveness of the relevant markets to determine whether it is appropriate to reduce regulation of the LECs."[11]

The IXC's proposals all but guarantee that streamlining will be delayed until long after it is warranted, an outcome that suppresses competition and leads to the elimination of consumer benefits that are otherwise available.

A competitive checklist should be designed so as to provide a predefined methodology for evaluating requests for regulatory relaxation. The obvious danger of a checklist is that it can lead to streamlining prematurely, or alternatively, delay streamlining when current conditions warrant a different outcome. Thus, the critical inquiry is whether the conditions enumerated on the

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[9] Comments of MCI Communications Corporation at p. 22.

[10] AT&T Comments at pp. 6-7.

[11] Id. at p. 16.

checklist accurately assess competition, both existing and potential, for purposes of granting or denying streamlining requests. Ameritech's proposed checklist[12] passes this test; those offered by commenters, without exception, impose requirements that are highly biased toward a finding that competitive conditions fail to justify streamlining.

Consistent with the Commission, Ameritech embraces demand and supply responsiveness as the key components in a sound competitive assessment. As Ameritech correctly explains, calibrating demand responsiveness is both meaningful and easily accomplished. Ameritech proposes that

> "If an alternative [service] is available, it should be a given that access customers will be aware of that alternative and willing to avail themselves of it to obtain a better deal. Consequently, in considering streamlining requests, the Commission should hold that demand-elasticities are presumptively high in any cluster of contiguous wire centers if, in each wire center in that cluster, at least one CAP and/or alternative local exchange carrier is providing or could readily provide the services in question or substitutable services."[13]

Because the telecommunications industry is characterized by large, sophisticated purchasers who have every interest in availing themselves of new services that provide superior price and quality combinations relative to the incumbent's offerings, Ameritech's proposal offers an efficacious test for calibrating demand elasticities.

A more complex review is needed to evaluate supply responsiveness, but Ameritech's Comments again lay out a framework that provides the Commission with a robust method of examination. Ameritech proposes two tests that address supply responsiveness, relying on capacity in the first instance and entry conditions in the second. With regard to capacity, the factfinder should devote attention to both existing capacity and the ease with which additional

[12] Comments of Ameritech at pp. 28-33.

[13] Comments of Ameritech at pp. 27-28.

capacity could be acquired. Ameritech suggests that sufficient supply elasticity should be found when

> "... competitive facilities are available to customers representing at least 25% of all access traffic in the geographic market in question ... and that those facilities can accommodate immediately at least one fifth of the traffic represented by those customers."[14]

With respect to entry conditions, Ameritech recommends that the Commission find entry barriers to be sufficiently relaxed when there exist tariffs for unbundled loops and ports, arrangements for interconnection, interim number portability and reciprocal compensation, and the availability of fair and equal access to numbering resources.[15] In conjunction with meeting these conditions, Ameritech further proposes that the likelihood of competition be corroborated with the existence of at least one certified local exchange carrier offering service within the relevant geographic market.[16]

Perhaps the most important feature of Ameritech's proposed checklist approach is that the checklist will not be applied as an absolute determinative tool. The checklist provides incumbents with a predefined set of criteria that, if met, lead to the granting of streamlining requests, but if the criteria are not met, the checklist does not propose that the inquiry be terminated. Rather, moving parties are then given the opportunity to bring forward additional evidence of local competition that may justify approval. This flexibility should be contrasted with the checklists offered by commenters, which would be implemented mechanically to determine the degree of competition. Ameritech's checklist approach recognizes that a list can never account for all possible sources of competitive entry.

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[14] Id. at p. 31

[15] Id. at pp. 31-32.

[16] Id.

Ameritech's competitive checklist approach can be thought of as defining a safe harbor of conditions that, if met, will permit the Commission to confidently and fairly approve streamlining requests. But importantly, failure to meet the checklist's requirements does not foreclose regulatory relaxation. The checklist is indicative, not determinative. If, for whatever reason, the checklist does not lead to a finding of regulatory relaxation, Ameritech's proposal permits LECs to bring forward additional evidence that is equally relevant to the assessment of local competition. This provides the necessary flexibility to take account of specific situations and unanticipated developments.

C. Changing technology and evolving industrial structures and regulation render the use of static market statistics wholly inappropriate.

A number of commenters endorse market share, as though this one number is the talismanic indicator of local competition. Perhaps the most ardent advocate is Time Warner, which states matter of factly that "market share is the best indicator of competitive success." Time Warner goes on to say that "Until LECs demonstrate that their competitors have managed to obtain and hold on to significant market share, the Commission should not consider granting further relaxation of pricing constraints."[17] To be quite blunt, this is bad economics. It confounds the protection and advancement of competition and competitors. Competition policy which shackles one group of competitors and favors another will generate inefficiencies that ultimately harm consumers.

[17] Comments of Time Warner Communications Holdings Inc. at p. 7.

The National Cable Television Association likewise ardently advances an actual competition standard in this proceeding, although elsewhere it has disavowed and contradicted such a standard. In its Comments regarding the waiver of the Commission's rules regulating rates for cable services, NCTA states that

> "the mere presence of an alternative multichannel provider with even an initial small market share, but capable of expanding its sales, disciplines an incumbent operator well before the new entrant takes a substantial share of the market."[18]

NCTA explains further that the Commission should

> "recognize the constraining effect on the cable operator of the MVP's potential competition once it is authorized to provide service to the incumbent cable operator's customers and grant the proposed waivers upon such authorization."[19] [emphasis in original]

For the instant proceeding, however, NCTA propounds the idea that "the fundamental problem [with] the Commission's approach is that it provides regulatory relief to LECs before competitors enter the market ..."[20] [emphasis in original] It would appear from these contrasting statements that NCTA's position is driven by its own economic self-interest and its desire to manipulate the regulatory system to disadvantage its competitors.

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[18] Comments of NCTA in the Matter of Waiver of the Commission's Rules Regulating Rates for Cable Services, December 13, 1995 at p. 7.

[19] Id. at p. 14.

[20] Comments of NCTA in Second FNPRM at p. 10.

A myopic emphasis on current competitors and shares, especially in an industry dominated by momentous and frequent technological innovation, will also grossly understate the degree of competition, both actual and potential. Indeed, the Justice Department explicitly recognizes the important role of innovation in evaluating market metrics:

> "However, recent or ongoing changes in the market may indicate that the current market share of a particular firm either understates or overstates the firm's future competitive significance. For example, if a new technology that is important to long-term competitive viability is available to other firms in the market, but is not available to a particular firm, the Agency may conclude that the historical market share of that firm overstates its future competitive significance."[21]

In the case of the LECs, focusing on current position in the local exchange is clearly a distortion of the competitive situation, particularly if an unbundling program is in place and regulatory constraints hobble the incumbent.

Accepted economic theory and the Merger Guidelines indicate that one ought to include in the market today the capacity currently outside the market that could enter and exit at low cost within one year ("uncommitted" entry).[22] In the instant case, there are two clear sources of existing capacity which could play an important role in the market. First, there is significant capacity used for other applications which can be modified for local exchange and access use at incremental costs much lower than *de novo* entry. The facilities of CAPs, IXCs, cable companies, wireless carriers, and private networks can, at least in part, be adapted for the provision of local exchange and access services. Second, Ameritech's and other LECs' loop unbundling will facilitate uncommitted entry (and exit) and eliminate the need to incur up-front, irreversible sunk costs.

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[21] Department of Justice and Federal Trade Commission, Merger Guidelines, April 2, 1992 at pp. 31-32.

[22] Id. at 20.

The Merger Guidelines state clearly that in addition to "uncommitted entry" (which does not require significant sunk costs) the agencies will also take into account committed entry (that which requires expenditure of significant sunk costs) in its analysis of competition.[23] The DOJ has already recognized that in markets where entry is easy, even if current concentration is high, there are no antitrust concerns.[24] Reliance on raw, historical concentration numbers is especially inappropriate in the face of the recent, and significant, easing of barriers to entry witnessed in local telecommunications. Yet the commenters' proposed methods of assessing local competition do not even endeavor to consider information on this source of competition. Clearly they are out of step with contemporary policy and modern methods of competitive assessment.

The frequency of new organizational arrangements presently taking place in communications is symptomatic of the dynamic nature of competition and the opportunities created by technological innovation. Any one of the recent mega-deals involving cable and wireless interests could take telecommunications services in a new direction and make a current static measure even more obsolete and misleading.[25] New organizational arrangements are spurred at least in part by new technologies which facilitate entry into telecommunications and which will blur still further the distinctions between the telecommunications, cable, and computer industries. In fact, some reorganization activity can be attributed to the state of uncertainty that pervades the industry, as firms jockey to position themselves to lead the direction of the industry. This same uncertainty cautions against the use of any sort of static measure to assess and predict Ameritech's competitive capabilities. The risk of producing a wholly inaccurate analysis and slowing the course of competition is simply too great.

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[23] Id. at 20-21.

[24] Id. at 47.

[25] Just two of numerous developments occurring over the past several years are AT&T's acquisition of McCaw Cellular and the creation of the PCS consortium comprised of Sprint, Teleport and several cable companies.

The Commission's review of local competition should also consider regulatory reforms occurring in numerous regions in the U.S. and their likely impact on conditions of entry going forward. For example, within Illinois and Michigan, all remaining meaningful barriers to entry are being removed and entry is encouraged by the CFP program which promotes new entry through the implementation of unbundled loops, reciprocal compensation, interconnection, resale, support services, and other favorable conditions. Competitive carriers are being certified to provide local exchange service in both states. Rules governing interconnection have been put into action, thereby ensuring that the customer's ability to send and receive calls will remain unchanged regardless of choice of carriers. Mutual compensation has been arranged so that new carriers are fairly compensated for traffic they terminate. Ameritech has made available interim number portability options, and the company is working with the industry to develop a long-term service. Finally, unbundling of loops and ports creates possible entry strategies that require minimal up front capital investment. As already pointed out, these developments are sure to promote and accelerate new entry into the local exchange. They are tantamount to assisted entry -- the polar opposite of entry barriers.

A final point to be made relates to existing and historical regulations and their tendency to grossly distort the market statistics that various commenters endorse. A prime illustration is Ameritech's supposed high "market share," which the interexchange carriers (IXCs) in particular have highlighted as overwhelming evidence of the continuing competitive void in the local exchange. In fact, historical market share, especially as constructed by the IXCs, is a highly biased measure of competition since it utterly ignores the franchise obligations of the LECs. Ameritech does not choose to make many of its sales - it is obligated to make them through its universal service obligation. When regulators set rates below competitive levels, those sales provide no evidence whatsoever of Ameritech's market power; they merely reflect the fact that Ameritech is successfully fulfilling its regulatory obligations. A competitive assessment that